



# USAG Ansbach Activity Based Costing Overview



# Fundamental flaws with traditional costing



A costing approach that uniformly assigns (“spreads”) the cost of resources to cost objects (such as products, services, or customers) when the individual products, services, or customers use those resources in a non-uniform way.

It is called the “Peanut Butter Effect”





## Example: General Admin Costs

	FTE	% FTE	G & A
Personnel	2,360	17%	17 %
Accounting	8,263	60 %	60 %
Administration	3,193	23%	23%

### Consumption-Based Assignment of G/A Costs



# How does ABC differ from traditional costing?

## **Traditional Costing**

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- > Makes me aware of how much I spent
- > Does not tell me a lot about my costs
- > Does not tell me what to do or where to look to reduce my cost
- > Does not teach me how to be more efficient

## **Activity-Based Costing**

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- > Makes me aware of where I spent
- > Gives me visibility into my costs
- > Gives indications on where to look and start to reduce cost
- > Gives me a baseline to evaluate my efficiency improvements



# Traditional Costing vs. ABC



- Traditional costing systems manage dollars (resources)
- How would you reduce costs by 10%?
- Activity-based costing systems measure work (Activities and processes)
- Would you make a different decision about saving 10%?

## Warehouse Budget

<b>Labor</b>	<b>\$ 250,000</b>
<b>Supplies</b>	<b>120,000</b>
<b>Equipment</b>	<b>60,000</b>
<b>Other</b>	<b><u>32,000</u></b>
<b>Total</b>	<b>\$ 462,000</b>

## Warehouse Activities

<b>Receive material</b>	<b>\$ 137,000</b>
<b>Store material</b>	<b>36,000</b>
<b>Deliver material</b>	<b>169,000</b>
<b>Expedite material</b>	<b><u>120,000</u></b>
<b>Total</b>	<b>\$ 462,000</b>



# So, What is Activity-Based Costing?



# What is ABC?

- Determines ***what*** work is being performed
- Provides an accurate picture of the ***total cost*** of producing outputs
- An enabler of change by providing a ***process view*** of operations to measure the effectiveness of the outcome
- A ***management tool*** that provides insights into the cost performance of an organization at all levels to manage performance effectively



# ABC misconceptions



ABC is not. . .

- an alternative to the current accounting system
- a “Silver Bullet”/Panacea/ crystal ball
- an initiative or flavor of the month
- a software or a computer model
- easy to get to requiring little effort

ABC is a departure from traditional costing paradigm.



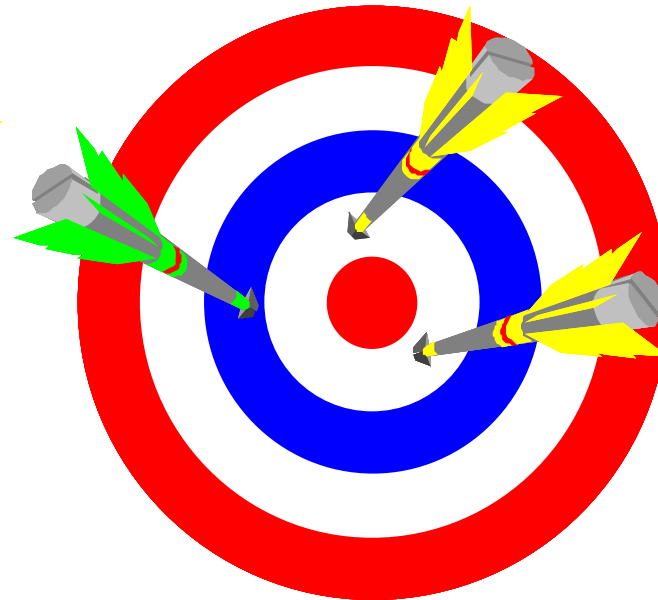
# Focus on accuracy, not precision



**Very precise, but  
not accurate**



**Accurate, but less  
precise**



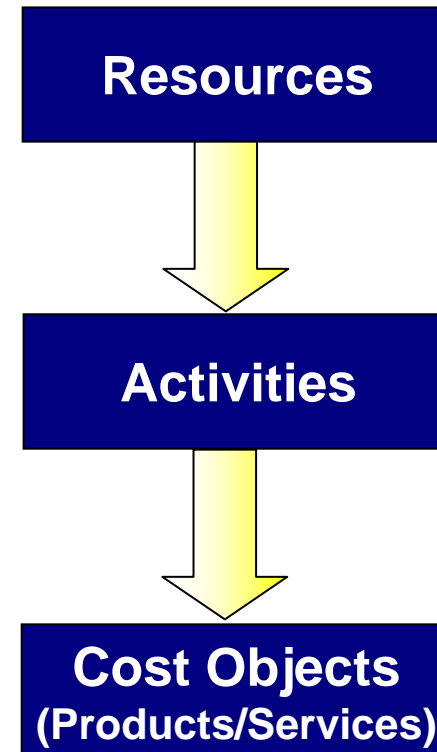
**It is better to be about right, than precisely wrong.**



# The ABCs of ABC

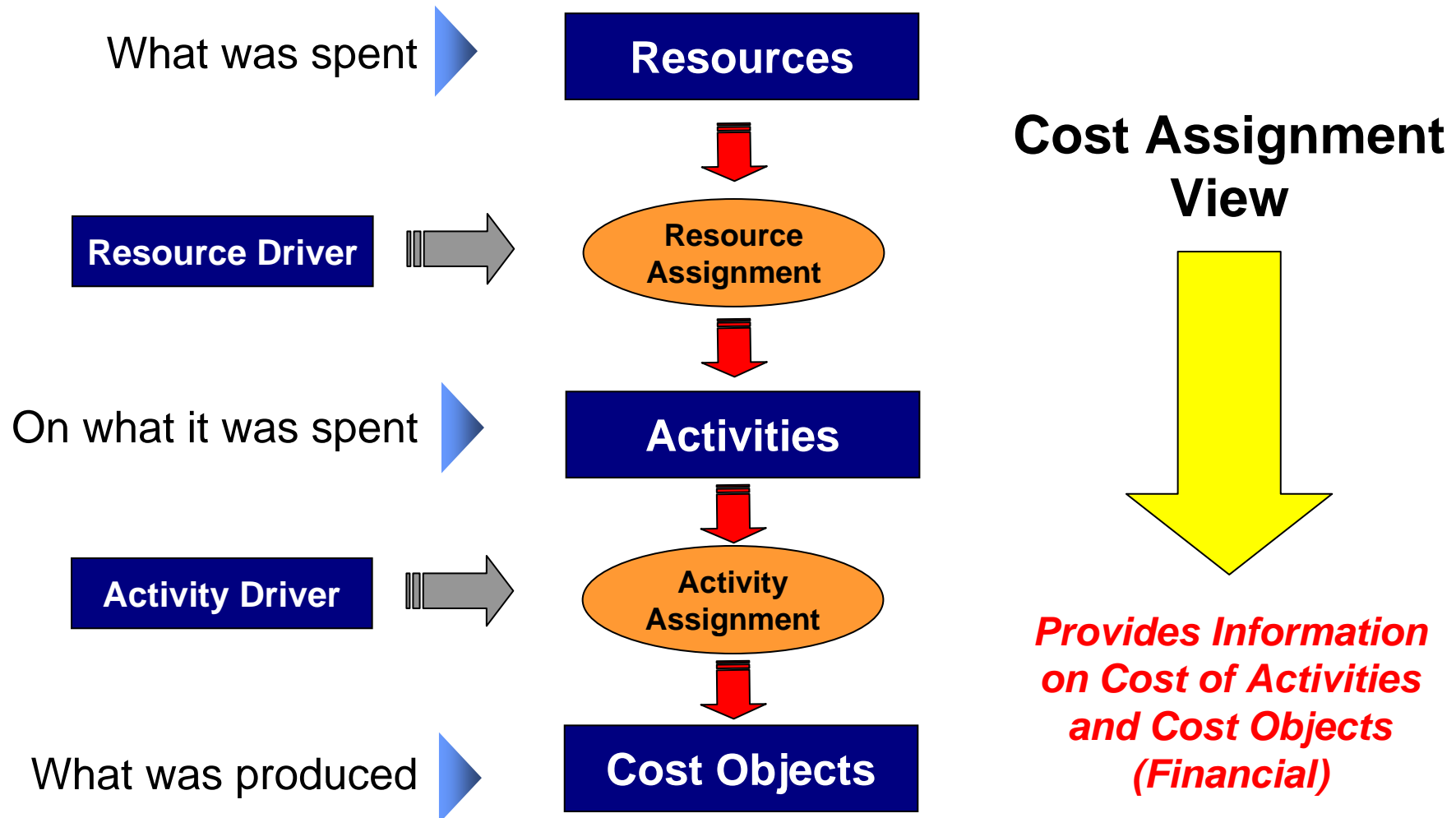
ABC operates on a simple concept of two-stage assignment of costs

- Resources are consumed by activities
- Activities are consumed by products/services to satisfy customer demands





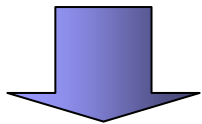
# How it works?



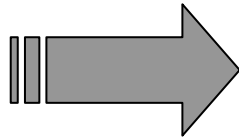


# How does it help?

Helps Determine the  
Workload of an Activity



**Cost Drivers**

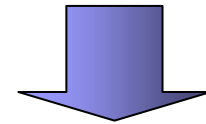


**Activities**

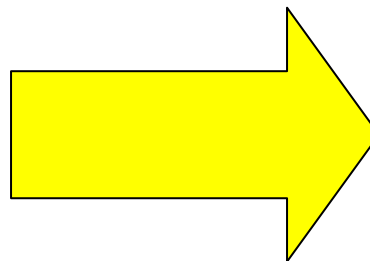


**Performance  
Measures**

Helps Determine How Well  
an Activity is Performed



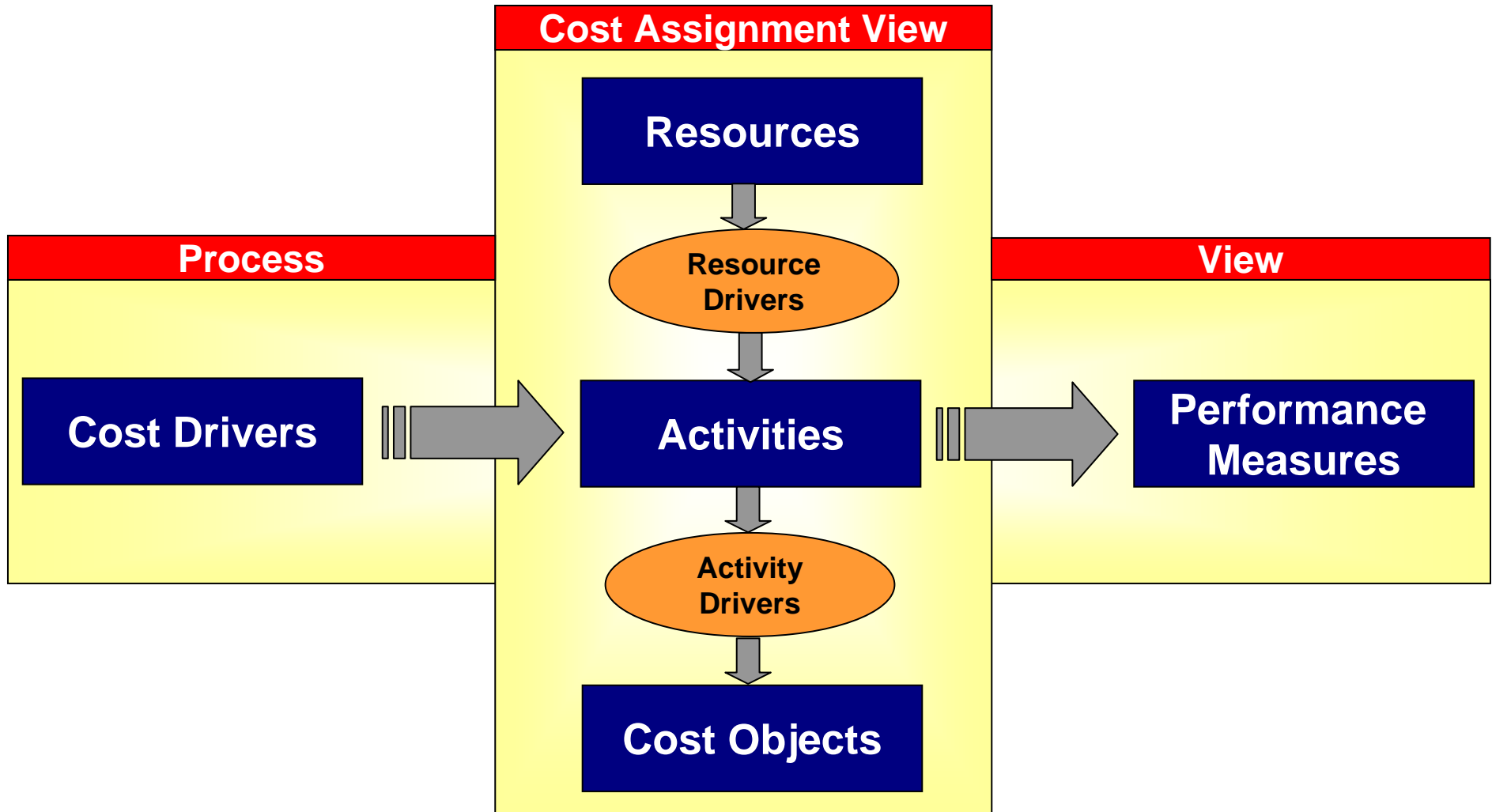
**Process View  
Dimension**



***Provides Information  
About the Work Done  
in the Activity/Process  
(Non-Financial)***



# The ABC/M Methodology



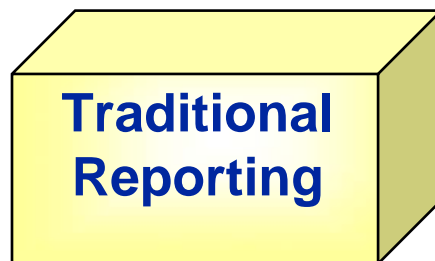


# How to use ABC information? Activity-Based Management (ABM)



# The new paradigm – Performance Management

Says a lot about what  
was spent

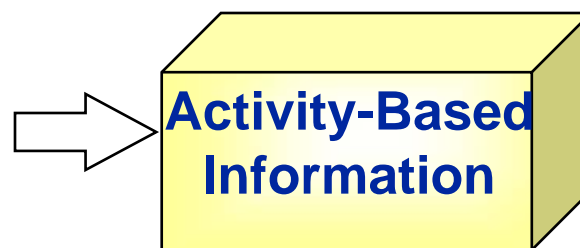


Usually reports  
on General  
Ledger account  
summary



Data

Need to know where  
it was spent



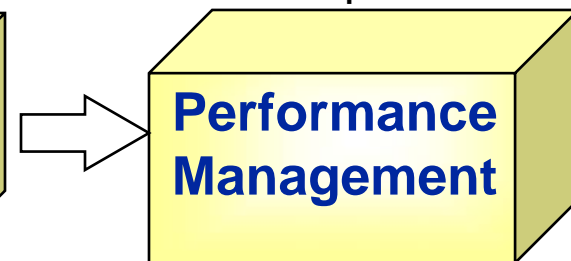
Financial data  
related to work  
performed in an  
organization; makes  
sense to most  
people



Work information

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What we REALLY need  
to know is how it was  
spent



Allowing people to  
be effective  
managers of their  
respective areas,  
functions, divisions  
or Garrisons



Mgmt. Decision Support  
Information



# Activity-Based Management (ABM)

What is ABM?

- A management philosophy that uses Activity-Based information to provide visibility into “what work gets done” (activities and processes), “how much it costs” and “how well it is performed”
- Highlights potential improvement opportunities and provides a framework to measure the effectiveness of the improvement effort
- A foundation to measure and manage organizational performance across all levels and all dimensions



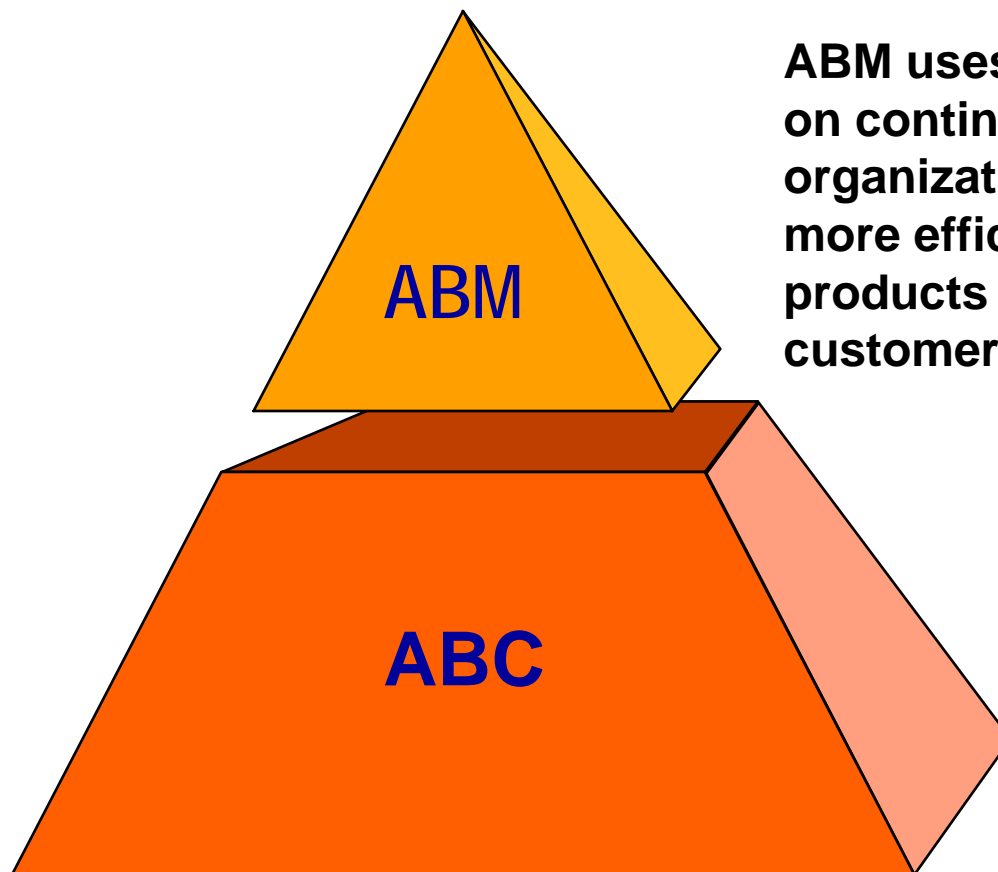
# Prerequisites for successful ABM



- A compelling need to act
- Timely, sustainable ABC information
- Ready access of ABC information to managers
- A toolkit of techniques and approaches to achieve results



# ABM applications



**ABM uses ABC information to focus efforts on continuously improving the organization's ability to perform the mission more efficiently while improving the products and services provided to the customers**

**ABC identifies the cost of activities, processes, and cost objects**



# ABM applications

ABM incorporates the use of activity-based costing and performance data with Action

$$\text{ABM} = \text{ABC} + \text{ABP} + \text{MA}$$

Activity-Based Management

Activity-Based Costing

Activity-Based Performance

Management Action

Action taken by managers to enhance business performance and *satisfy customers* while continuously reducing and controlling costs.